



Comptroller's Office Internal Memorandum

October 13, 2004

TO: Mayor Joe Wardy
City Council
Ms. Joyce Wilson, City Manager

FROM: Carmen Arrieta-Candelaria, Comptroller

SUBJECT: Scope of Work for Expanded Annual Audit

The scope of work for KPMG for an expanded annual independent audit for the fiscal year ended August 31, 2004, is attached. This item is being placed for consideration on the October 19, 2004, City Council Agenda. The *Scope of Work* outlines the general scope of the audit as well as three focus areas identified by the City Manager.

KPMG will review these focus areas, with concurrence from Council, in order to provide guidance and assurance in the financial matters of the City. These key areas will generate the most relevant information and can be expanded upon as deemed appropriate. These areas include:

- El Paso Firemen and Policemen Pension Fund
- Debt Service Fund Additional Procedures
- GFOA Recommended Practices

If you have any questions, please do not hesitate to contact my office. Thank you for your consideration.

City of El Paso
Scope of Work for KPMG for Audit Services
For the fiscal year ended August 31, 2004

General Scope of Work

The general objective of an audit is the expression of an opinion as to whether the presentation of the financial statements conforms with accounting principles generally accepted in the United States of America. In conducting the audit, KPMG will perform tests of the accounting records and such other procedures as KPMG considers necessary in the circumstances to provide a reasonable basis for their opinion on the financial statements. They will also assess the accounting principles used and significant estimates made by management as well as evaluate the overall financial statement presentation. Management is responsible for the fair presentation, in accordance with generally accepted accounting standards, of the financial statements and all representations contained therein.

In addition to the opinion issued, KPMG provides a written report, Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standard, on their consideration of internal control and test of compliance that are made as part of the audit of the financial statements.

A management letter is also issue in accordance with GAS in order to communicate to Mayor and Council other deficiencies in internal controls that are not reportable conditions and other violations of grants and contracts, and abuse that come to KPMG's attention unless they are clearly inconsequential.

KPMG is also required in certain circumstances to report fraud or illegal acts directly to parties outside the auditee.

An additional written report is also issued which provides an opinion on the schedule of expenditures of federal and state awards in relation to the City's financial statements. It also provides an opinion on compliance with laws, regulations, contracts and grants that could have a direct and material effect on major federal and state programs and KPMG communicates their consideration of internal control over major federal and state programs. This information is solely intended for the use of the City Council and management of the City and federal and state awarding agencies and pass-through entities and it is not intended to be and should not be used by anyone other than these specified parties.

The fees for these aforementioned services is \$272,000, which is paid from the City's general fund as well as the Airport, Solid Waste, and Sun Metro. A copy of the engagement letter which outlines the full agreement between the City and KPMG is available upon request.

El Paso Firemen and Policemen Pension Fund

An additional review of the issues raised by the City Attorney's Office regarding the exclusion of the El Paso Firemen and Policemen Pension Fund (EPFPPF) as a component unit in the City's financial statements for the fiscal years ending August 31, 2000, 2001, 2002, and 2003. Management will review the inclusion of the EPFPPF as a component unit for the fiscal year ended August 31, 2004, as well as ensure compliance with GASB 14 and 29. The rationale of the determination to exclude the EPFPPF will be reviewed by KPMG.

Debt Service Fund Additional Procedures

A review of the debt service policies in place will be performed by KPMG. The fund balance of the debt service will be reviewed to ensure compliance with those policies. Revenues and expenditures will be reviewed thoroughly to ensure that amounts were posted correctly to the fund.

The Notice of Effective Tax Rate will be audited to ensure the figures posted on the 3rd Corrected Notice and prior are reasonable and comply with Truth in Taxation laws.

GFOA Recommended Practices

The Government Finance Officers Association (GFOA) has developed a body of recommended practices in functional areas of public finance to give GFOA members and other state and local governments more guidance on sound financial management practices. These recommended practices are intended to identify enhanced techniques and provide information about effective strategies for state and local government practitioners. The City of El Paso has identified twelve of these strategies that will be reviewed in conjunction with the audit for the fiscal year ended 2004.

They are as follows:

1. Establishment of an Internal Audit Function
2. Appropriate Level of Unreserved Fund Balance in the General Fund
3. Recommended Budget Practices of the National Advisory Council on State and Local Budgeting
4. Use of Financial Status in the Budget Process
5. Adoption of Financial Policies
6. Sustainability
7. Procurement of Banking Services
8. Electronic Transactions for State and Local Governments
9. Purchasing Card Programs
10. Revenue Policy: Cash Receipts Controls
11. Revenue Policy: Accounts Receivable Controls
12. Debt Management Policy

The above focus areas will generate the most relevant information and will provide guidance about the financial affairs of the City. Following is a brief summary of each focus area.

Establishment of an Internal Audit Function

A well-established internal audit function works directly for management, at some level, and recognizes that its primary responsibility is helping management to fulfill its duties as effectively and efficiently as possible. Internal auditors commonly assist management in monitoring the design and proper functioning of internal control policies and procedures. Internal auditors also can play a valuable role conducting performance audits, as well as special investigations and studies. Internal auditor's report as well as the annual audit work plan should be reviewed and approved by the City Manager and an established audit committee.

The City should consider the full implementation of a formal internal audit function because such a function can play an important role in helping management to maintain a comprehensive framework of internal controls. As a rule, a formal internal audit function is particularly valuable for those activities involving a high degree of risk (e.g., complex accounting systems, contracts with outside parties, a rapidly changing

environment). In addition, reliance could be placed on an internal audit function such that it may reduce external auditing costs.

Appropriate Level of Unreserved Fund Balance in the General Fund

Given the recent scrutiny of the level of appropriateness of unreserved fund balance in the general and other funds by the public, the City deems it necessary to have a review of all of its fund balances and the purposes of such. Although, fund balance is intended to serve as a measure of the financial resources available in a governmental fund, the City may have designated future uses of these funds in the next budgetary cycle.

In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unreserved fund balance in the general fund. Credit rating agencies carefully monitor levels of fund balance and unreserved fund balance in a government's general fund to evaluate a government's continued creditworthiness. Likewise, laws and regulations often govern appropriate levels of fund balance and unreserved fund balance for state and local governments.

The GFOA recommends the establishment of a formal policy on the level of unreserved fund balance that should be maintained in the general fund as well as similar policies for other types of governmental funds. This will provide management with a temporal framework as well as specific plans for increasing or decreasing the level of unreserved fund balance if determined to be inconsistent with the adopted policy. This policy implementation may be looked favorably by interested parties such as rating agencies that are likely to favor increased levels of fund balance and taxpayers who might view high levels of fund balance as "excessive."

Recommended Budget Practices of the National Advisory Council on State and Local Budgeting

The GFOA recommends that local governments look to the recommended practices of the NACSLB as a model for evaluating and improving their own budget policies and procedures, with the goal of ultimately developing, adopting and implementing their budgets in accordance with these recommended practices. Given the evolving nature of good budgeting and management, these practices are not intended as mandatory prescriptions for governments. Rather, they are recommendations that provide a blueprint for governments to make improvements to their budget processes. The City will review its budgeting practices and compare with GFOA's key characteristics of the budget process to ensure that sound budgeting practices are in place.

Use of Financial Status in the Budget Process

The GFOA recommends that a component of the budget process be an overall financial status of the governmental entity and of its key funds, including but not limited to an analysis of available financial resources. This brief analysis should discuss the current financial status, the immediate future status, and long-term trends. The emphasis on this analysis is on understandability of the financial status and issues, not necessarily on exact numbers and detail. This analysis should be provided, at least in written form, early in the process so a broad financial framework is available to stakeholders and decision-makers. The final budget materials should contain an updated status report.

Adoption of Financial Policies

The GFOA recommends that, at a minimum, financial policies in the areas of financial planning, revenue and expenditures be developed by professional staff and formally adopted by the jurisdiction's governing board as well as other related parties such as component units.

The City's adopted financial policies should be used to frame major policy initiatives and be summarized in the budget document. It is further recommended that these policies, along with any others that may be adopted, be reviewed during the budget process. Professional staff should review the policies to ensure continued relevance and to identify any gaps that should be addressed with new policies. The results of the review should be shared with the governing board during the review of the proposed budget

Sustainability

The GFOA recommends that the issue of sustainability be considered a core value in setting organizational policy and establishing business practices in all areas of public finance. Sustainability is the notion that current economic and consumption patterns should not reduce opportunities for future generations by depleting or impairing resources. . The City may consider those actions recommended by GFOA that would add value in the areas of public policy, budget and management, and sustainable business practices.

Procurement of Banking Services

State and local governments use a wide variety of banking services for the deposit, disbursement, and safekeeping of public monies. Prudent procurement practices necessitate the reevaluation of banking services on a periodic basis. In addition, recent changes in technology, cash management practices, and banking industry structure offer public investors opportunities to reevaluate banking services and costs. The City is in the process of procuring banking services and will use this review as an opportunity to ensure best practices.

Electronic Transactions for State and Local Governments

State and local governments are responsible for making a wide variety of payments to their employees, program recipients, vendors and other governments. In addition, governments receive revenue and fees from a wide variety of sources. Processing these disbursements and receipts can be time-consuming, resource intensive, and costly. The GFOA recommends that state and local governments evaluate opportunities to make and receive electronic payments in many areas. KPMG will review and make recommendations in areas where electronic transactions may be additionally feasible.

Purchasing Card Programs

The purpose of a purchasing card (also known as a procurement card) program is to provide an efficient, cost-effective method of purchasing and paying for small-dollar as well as high-volume, repetitive purchases. This type of program is designed as an alternative to the traditional purchasing process and can result in a significant reduction in the volume of purchase orders, invoices, and checks processed. Purchasing cards can be used whenever a purchase order, check request, or petty cash would have been processed and with any vendor that accepts credit cards. The GFOA recommends that governments explore the use of purchasing cards to improve the efficiency of their purchasing procedures.

Revenue Policy: Cash Receipts Controls

To ensure strong financial management practices, the proper controls over revenues are imperative in determining budget, forecasting, reconciliations and general oversight over the various revenues collected. As part of performing governmental services, management must provide for appropriate mechanisms, automated and manual, to collect all funds for services performed and ensure that proper controls exist over all receipts.

This recommended practice advocates for the inclusion of cash receipts controls and policy statements as part of a revenue policy. This will ensure that the City is properly accounting for and have appropriate controls over its cash receipts.

Revenue Policy: Accounts Receivable Controls

To ensure strong fiscal management practices, the proper controls over revenues are imperative in accounts receivable management and general oversight over the various revenues collected. Sometimes governmental services are provided on credit. This generates the need to set up accounts receivables and thereafter, a process to collect these receivables. It is incumbent on management to ensure proper controls exist over these receivables. The City's revenue policy should be reviewed to ensure that the internal controls exist and that collections are being done on a timely basis.

Debt Management Policy

Debt management policies are written guidelines and restrictions that affect the amount and type of debt issued by a state or local government, the issuance process, and the management of a debt portfolio. A debt management policy improves the quality of decisions, provides justification for the structure of debt issuance, identifies policy goals, and demonstrates a commitment to long-term financial planning, including a multi-year capital plan. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and should meet its obligations in a timely manner. In addition, this policy can lend public confidence in the management of the City's debt affairs. The GFOA recommends that all state and local governments adopt comprehensive written debt management policies, and that governments review them at least annually and revise them as necessary.

Some of the above services can be reviewed in conjunction with the general scope of work. The additional estimated cost of the items outside this scope is \$50,000. The expected completion date of the work would be December 2004.